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No. 07-

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ROYAL SURPLUS LINES INSURANCE COMPANY,

Petitioner,

v.

NORTHFIELD INSURANCE COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Is subject matter jurisdiction lacking, under California law, with respect to a cause of action against a liability insurer for alleged bad faith failure to settle a claim against an insured within policy limits, where no judgment against the insured was ever entered?

2. If subject matter jurisdiction is absent in a federal district court in a diversity case, as to the cause of action on which a monetary judgment is based, is a federal appellate court required to reverse the judgment with directions to dismiss the case?

LIST OF PARTIES AND STATEMENT PURSUANT TO RULE 29.6

The parties to this proceeding are two insurance companies.

The petitioner is Royal Surplus Lines Insurance Company, which was the defendant in the District Court. Arrowpoint Group, Inc., is now the owner of 100% of the stock of Royal Surplus Lines Insurance Company. Arrowpoint Group, Inc., is the holding company for the former subsidiaries in the United States of Royal & SunAlliance Insurance Companies, including Royal Surplus Lines Insurance Company. The ultimate parent of Arrowpoint Group, Inc., is Arrowpoint Capital Corporation.

The Respondent is Northfield Insurance Company.

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The petitioner, Royal Surplus Lines Insurance Company, seeks review of a judgment based on a cause of action that does not exist. Because there is no cause of action, there was no subject matter jurisdiction in the District Court. Nonetheless, the United States Court of Appeals for the Ninth Circuit has affirmed the judgment in favor of respondent Northfield Insurance Company, the plaintiff in the trial court. The absence of subject matter jurisdiction requires that an appellate court reverse a judgment and remand with instructions to dismiss. Since the Ninth Circuit has failed to fulfill its constitutional obligation with respect to the absence of subject matter jurisdiction, the petitioner seeks review by the Supreme Court of the United States.

CITATIONS OF OPINIONS AND ORDERS

The present insurance bad faith action was originally filed in state court, but was removed to the United States District Court for the Central District of California, *Northfield Insurance Company v. Royal Surplus Lines Insurance Company*, case number CV-03-0492. The District Court granted partial summary judgment in favor of Northfield, finding that Royal had acted in bad faith in failing to settle the underlying personal injury action in state court within its primary policy limits. The lawsuit proceeded to a court trial at which damages in favor of Northfield were awarded in the amount of $7,155,274.08, plus interest at 7% from August 10, 2000, to the date of signing of the judgment, which was January 23, 2006. [Appendix B.]

Royal appealed from the judgment to the United States Court of Appeals for the Ninth Circuit, *Northfield Insurance Company v. Royal Surplus Lines Insurance Company*, Ninth Circuit case number 06-55256. The judgment of the District Court was affirmed in an unpublished memorandum decision. [Appendix A.] Royal's petition for rehearing was denied.

JURISDICTIONAL STATEMENT

The United States District Court for the Central District of California had jurisdiction pursuant to 28 U.S.C. § 1131(a), because the lawsuit is between citizens of different states, and the amount in controversy exceeds $75,000.00, exclusive of interest and costs. The United States Court of Appeals for the Ninth Circuit had jurisdiction pursuant to 28 U.S.C. § 1291, after the defendant filed a timely notice of appeal on February 15, 2006 from the judgment entered against the defendant on January 25, 2006.

The jurisdiction of the Supreme Court of the United States is invoked pursuant to 28 U.S.C. § 1254(1). This petition for a writ of certiorari is timely, since it is filed within 90 days of the denial of the petition for rehearing by the Ninth Circuit on February 27, 2008.

CONSTITUTIONAL PROVISION INVOLVED

In pertinent part, Article III, Section 2, of the Constitution of the United States provides that:

> The judicial Power shall extend to all *Cases*, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; – to all Cases affecting Ambassadors, other public Ministers and Consuls; – to all Cases of admiralty and maritime Jurisdiction; – to Controversies to which the United States shall be a Party; – to *Controversies* between two or more States; – between a State and Citizens of another State; – *between Citizens of different States*, – between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

(Emphasis added.)

STATEMENT OF THE CASE

1. The Relevant District Court Pleadings.

After removal to Federal District Court, plaintiff Northfield Insurance Company, an excess insurer, filed its first amended complaint against defendant Royal Surplus Lines Insurance Company, a primary carrier. [AER, tab 1, pages 1-13, docket number 47.][1] Northfield alleged that Royal had wrongfully failed to settle an underlying personal injury lawsuit against the common insured of the companies within its policy limits, even though it had opportunities to do so, and that such conduct represented bad faith under California law. [AER, tab 1, pages 5-6, docket number 47.] The plaintiff further alleged that it was subrogated to its insured's rights against Royal after it contributed to a settlement following an adverse verdict.[2] [AER, tab 1, page 7, docket number 47.] There was no allegation that a judgment was ever entered against the defendant in the underlying personal injury action. [AER, tab 1, pages 1-13, docket number 47.]

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1. Royal arranged for a clerk's record, a reporter's transcript, and a two volume appellant's excerpts of the record ("AER") to be submitted to the United States Court of Appeals for the Ninth Circuit in connection with its appeal.

2. Northfield did not, and could not, plead any direct cause of action based on a alleged breach of duty owed by Royal to Northfield. No such duty exists, although an excess carrier may be subrogated to the insured's cause of action, if the insured is damaged by being subject to a judgment in excess of primary insurance limits. *Commercial Union Assurance Companies v. Safeway Stores, Inc.*, 26 Cal.3d 912, 917-918; 164 Cal.Rptr. 709, 712; 610 P.2d 1038, 1041 (1980).

Royal filed an answer to the first amended complaint, denying its material allegations. [AER, tab 2, pages 1-10, docket number 58.] In its answer, the defendant alleged, as an affirmative defense, that the first amended complaint failed to state facts sufficient to constitute a cause of action. [AER, tab 2, page 5, docket number 58.]

2. The Order Granting Partial Summary Judgment on the Claim of "Bad Faith."

Northfield filed a motion for partial summary judgment on its first amended complaint, and this motion was granted. [AER, tab 14, pages 1-47, docket number 137.] The court found that Royal had acted in bad faith in failing to settle the underlying litigation, but made no finding that Royal's insured had been damaged by entry of judgment. In accordance with the court's decision, the court signed a partial summary judgment and order specifying material facts to be without substantial controversy. [AER, tab 15, pages 1-19, docket number 157.]

3. The Judgment After a Court Trial.

The case proceeded to a court trial on damages, and the court rendered judgment in favor of the plaintiff in the sum of $7,155,274.08, plus interest. [AER, tab 22, pages 1-2, docket number 340; Appendix A.] The judgment included all sums contributed by Northfield to the settlement of the underlying personal injury case, including sums over and above Northfield's excess insurance policy.

From the money judgment against it, Royal Surplus Lines Insurance Company appealed. Its notice of appeal was filed on February 15, 2006. [AER, tab 23, pages 1-2, docket number 346.]

4. The Motion for Summary Disposition of the Appeal.

Prior to any briefing in the United States Court of Appeals for the Ninth Circuit, the defendant and appellant, Royal Surplus Lines Insurance Company, filed a motion for summary disposition of the appeal. This motion was based on the contention that a recent decision of the California Court of Appeal, *RLI Insurance Company v. CNA Casualty Company of California*, 141 Cal.App.4th 75, 46 Cal.Rptr.3d 667 (2006), conclusively established that no cause of action for bad faith failure to settle an underlying lawsuit ever came into existence due to the absence of entry of judgment against the insured. The *RLI* decision was handed down several months after the notice of appeal in the present case.

The motion for summary disposition was supported not only by copies of documents filed in the District Court, but also by a certified copy of the docket of the Los Angeles Superior Court in the underlying personal injury action, *Borgia v. Winer*, Los Angeles Superior Court case number BC 137050. The docket showed that no judgment was ever entered in *Borgia*. Thus, the moving party not only showed that the plaintiff had failed to plead and prove the existence of entry of judgment in the underlying case, but also that no judgment had in fact ever been entered.

The motion for summary disposition of the appeal, requesting reversal of the judgment with directions to enter judgment in favor of the defendant dismissing the action, was denied without prejudice.

5. The Appeal.

After the denial of the motion for summary disposition of the appeal, the bad faith case proceeded through briefing. The appellant's opening brief was filed on April 3, 2007. The appellee's brief was filed on July 31, 2007. The appellant's reply brief was filed on August 29, 2007.

Royal's primary contention on appeal was that no bad faith cause of action ever came into existence, since no judgment was ever entered against the company's insured in the underlying personal injury action.[3] Northfield acknowledged the absence of a judgment due to a settlement of the underlying action prior to entry of judgment, but contended that Royal had failed to preserve the issue of the nonexistence of a bad faith cause of action at the District Court level.

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3. In its appellant's opening brief, Royal Surplus Lines Insurance Company argued that the absence of a cause of action deprived the District Court and the Ninth Circuit of subject matter jurisdiction. [Appellant's Opening Brief, pages 45-46.] The company cited *Unruh v. Truck Insurance Exchange*, 7 Cal.3d 616, 622; 98 P.2d 1063, 1068; 102 Cal.Rptr. 815, 819 (1972), for the proposition that the failure of a complaint to state facts sufficient to constitute a cause of action represents lack of subject matter jurisdiction, which may be raised for the first time on appeal. Such a contention, according to the Supreme Court of California in *Unruh*, is "not waivable." 7 Cal.3d at 622; 498 P.2d at 1068; 102 Cal.Rptr. at 819.

The United States Court of Appeal for the Ninth Circuit heard oral argument on December 4, 2007.

6. The Ninth Circuit Memorandum Decision.

In a terse memorandum decision dated January 4, 2008, the United States Court of Appeals for the Ninth Circuit affirmed the judgment in favor of Northfield Insurance Company. [Appendix A.] The court devoted but a single sentence to Royal's primary contention on appeal, the claim that the purported "bad faith" cause of action never came into existence, so as to deprive the court of subject matter jurisdiction. In particular, the Ninth Circuit ruled as follows:

> Finally, because Royal failed to raise its 'final judgment' argument sufficiently for the district court to rule on, we decline to consider it now. *See In Re Fegert, Inc.*, 887 F.2d 955, 957 (9th Cir. 1989).

7. The Petition for Rehearing.

On January 18, 2008, Royal Surplus Lines Insurance Company filed its petition for rehearing. Citing *Steel Company v. City for a Better Environment*, 523 U.S. 83 (1998), and other authorities, Royal argued that the Ninth Circuit erred in declining to consider the legal effect of lack of subject matter jurisdiction. The company contended that, if subject matter jurisdiction is absent, an appellate court must reverse a judgment and remand with directions to dismiss.

The petition for rehearing was denied. [Appendix C.][4]

8. The Urgent Need for Review.

Under California law, no cause of action against an insurer for failure to settle a lawsuit against its insured accrues unless and until judgment has been entered in the trial court against the insured. Neither the insured nor any excess insurer has or can be subrogated to a cause of action prior to that time, because the insured is not damaged unless and until judgment is entered. If a case is settled before entry of judgment, there is no cause of action for bad faith failure to settle, since liability insurers have the right to settle actions against their insureds if they choose to do so.

Because no bad faith cause of action ever came into existence against Royal, the present judgment, amounting to more than ten million dollars with interest, is based on a cause of action that does not exist. If a cause of action does not exist, there is no subject matter jurisdiction.

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4. Shortly after the denial of rehearing, Royal Surplus Lines Insurance Company paid the full amount of the judgment under protest. Of course, the subsequent mandate of the Ninth Circuit did not destroy the power of the Supreme Court of the United States to review the judgment of the Ninth Circuit. *Aetna Casualty Company v. Flowers*, 330 U.S. 464, 467 (1947). In addition, it is well established that an involuntary payment of a judgment does not render a petition for a writ of certiorari moot, since the money paid can be returned if the judgment is ultimately reversed. *Porter v. Lee*, 328 U.S. 246, 251 (1946); *Bank of Marin v. England*, 385 U.S. 99 (1966).

Under the decisions of the Supreme Court of the United States, the absence of subject matter jurisdiction means that there is no "case" or "controversy" within the meaning of Article III, Section 2, of the Constitution of the United States. It is therefore required that a federal court dismiss an action where subject matter jurisdiction is lacking.

If the lack of such jurisdiction is established at the appellate level, a federal appellate court must reverse a judgment grounded upon a claim lacking subject matter jurisdiction and order dismissal. In order to preserve the constitutional requirement of subject matter jurisdiction, this court should grant certiorari on the issues presented by the petitioner.

Another reason to grant certiorari is that the Ninth Circuit opinion unsettles what had been viewed in California as settled insurance law. Since unpublished decisions of the circuit courts of the United States are now citable, the insurance industry has been subjected to a dangerous and unsettling precedent. It is disconcerting for an insurer to settle a case and then be sued.

REASONS FOR GRANTING THE PETITION

I. The District Court Never Had Subject Matter Jurisdiction Over Northfield's Insurance Bad Faith Claim Against Royal, Because No Such Cause of Action Ever Came Into Existence, Due to the Absence of a Judgment Against Royal's Insured.

A liability insurance policy typically provides for a fixed amount of coverage, and invests the insurer with the decision making as to settlement. In order to restrict the right of insurers to gamble with their insureds' money, courts have imposed an obligation of good faith in the exercise by the insurer of the right to settle or not to settle. Breach of this obligation is usually described as the tort of "bad faith."

The first reported decision in California recognizing the existence of a cause of action against a liability insurer for failure to settle a claim against its insured within policy limits was *Brown v. Guarantee Insurance Company*, 155 Cal.App.2d 679, 319 P.2d 69 (1957). The Court of Appeal held that "the *insured's* cause of action arises when he incurs a *binding judgment* in excess of the policy limit." (Emphasis added.) 155 Cal.App.2d at 690; 319 P.2d at 75.

The holding of *Brown* was soon adopted by the Supreme Court of California, in *Comunale v. Traders & General Insurance Company*, 50 Cal.2d 654, 328 P.2d 198 (1958). Citing *Brown* and other authorities, the state Supreme Court held that

> [i]t is generally held that since the insurer has reserved control over the litigation and

> settlement, it is liable for the entire amount of a judgment against the insured, including any portion in excess of the policy limits, if in the exercise of such control it is guilty of bad faith in refusing a settlement.

50 Cal.2d at 660; 328 P.2d at 201. Of course, if there is no judgment against the insured, there is no bad faith action cause of action.

The Supreme Court of California has consistently followed the rule that, where a liability insurer is defending its insured, there can be no cause of action for failure to settle a lawsuit against an insured, unless and until judgment is entered against the insured in excess of policy limits. *Crisci v. Security Insurance Company*, 66 Cal.2d 425, 431; 426 P.2d 173, 177 (1967); *Johansen v. California State Automobile Association*, 15 Cal.3d 9, 16; 538 P.2d 744, 748 (1975); *Hamilton v. Maryland Casualty Company*, 27 Cal.4th 718, 725; 41 P.3d 128, 132 (2002). The same rule has been consistently recognized in the decisions of the intermediate California Court of Appeal, including *Doser v. Middlesex Mutual Insurance Company*, 101 Cal.App.3d 883, 890-892; 162 Cal.Rptr. 115, 119-120 (1980); *Finkelstein v. 20th Century Insurance Company*, 11 Cal.App.4th 926, 929; 14 Cal.Rptr.2d 305, 306-307 (1992); and *Safeco Insurance Company v. Superior Court*, 71 Cal.App.4th 782, 788; 84 Cal.Rptr.2d 43, 46 (1999). The *Safeco* court specifically held that "[a] cause of action for bad faith refusal to settle arises only after a *judgment* has been rendered in excess of the policy limits." (Emphasis added.) 71 Cal.4th at 788; 84 Cal.Rptr.2d at 46. Even if an insurer's refusal to settle a lawsuit was unreasonable,

there is no cause of action for bad faith unless and until there has been a judgment on the merits determining the insured's liability. *Wolkowitz v. Redland Insurance Company*, 112 Cal.App.4th 154, 163; 5 Cal.Rptr.3d 95, 103-104 (2003).

There was one aberrant decision in which, relying on authority from another state, the intermediate Court of Appeal appeared to dispense with the requirement of a judgment against the underlying insured, in an ambiguous and misleading decision, *Fortman v. Safeco Insurance Company*, 221 Cal.App.3d 1394; 271 Cal.Rptr.2d 117 (1990) However, the holding of the *Fortman* case was later rejected by the Supreme Court of California in *Hamilton v. Maryland Casualty Company*, 27 Cal.4th 718, 41 P.3d 128 (2002). The *Hamilton* court specifically held that "the claimant's action against the insurer does not mature, until a judgment in excess of the policy limits has been entered against the insured." 27 Cal.4th at 725; 41 P.3d at 132.

In *RLI Insurance Company v. CNA Casualty Company of California*, 141 Cal.App.4th 75; 45 Cal.Rptr. 3d 667 (2006), the Court of Appeal reviewed the extensive case law establishing the requirement of the underlying judgment. The Court of Appeal affirmed a judgment in favor of a primary insurer, where the primary insurer had been sued by an excess carrier for unreasonably refusing to settle a claim against the common insured of the carriers within primary policy limits. The trial court ruled that, because the underlying lawsuit was "settled instead of being litigated to judgment, the excess carrier has no right to pursue a subrogation claim." 141 Cal.App.4th at 79; 45 Cal.Rptr at 670. The Court of Appeal agreed.

The appellate court in *RLI Insurance Company* held that, as a matter of law, the excess carrier had no claim against the primary carrier, because the insured had no such cause of action to which the excess insurer could subrogate. 141 Cal.4th at 81; 45 Cal.Rptr.3d at 671. Relying on the state Supreme Court decision in *Hamilton* and on other authorities, the court flatly held that "[w]ithout an excess judgment, the primary insurer's refusal to settle is not actionable." 141 Cal.App.4th at 82; 45 Cal.Rptr.3d at 672. The court noted that, without entry of judgment, the insured suffered no harm, and thus there was no cause of action against the primary insurer in favor of the insured defendant or in favor of the excess insurer which had participated in a settlement reached before judgment was entered. 141 Cal.App.4th at 82-83; 45 Cal.Rptr.3d at 672. Interestingly, the *RLI* court specifically noted that the holding of *Fortman v. Safeco Insurance Company*, 221 Cal.App.3d 1394; 271 Cal.Rptr. 117 (1990) was clearly erroneous, since it conflicted with the decision of the Supreme Court of California in *Hamilton v. Maryland Casualty Company*, 27 Cal.4th 718; 41 P.3d 128 (2002), as well as being in conflict with all prior authority. 141 Cal.App.4th at 83-84; 45 Cal.Rptr.3d at 673-674.

In *Larraburu Brothers, Inc. v. Royal Indemnity Company*, 604 F.2d 1208 (9th Cir. 1979), the United States Court of Appeals for the Ninth Circuit recognized that, under California law, a bad faith cause of action against a primary insurer accrues only at the time of entry of judgment against the insured defendant. In an opinion authored by Circuit Judge (now Supreme Court Associate Justice) Anthony M. Kennedy, the Ninth

Circuit observed that the entry of final judgment is "the critical point" under California law that marks "the accrual of the cause of action against the insurer." 604 F.2d at 1215. The court recognized that "a plaintiff may not bring a bad faith action until a final judgment is entered in the original suit." 604 F.2d at 1215. In this case, unlike *Larraburu Brothers*, no judgment was ever entered against Royal's insured in the underlying litigation.

Under the cases cited above, it is clear that no cause of action in favor of Northfield Insurance Company ever came into existence against Royal Surplus Lines Insurance Company as a result of Royal's failure to settle the underlying personal injury case within policy limits. Although both the primary carrier and the excess carrier for the underlying insured paid more than their combined policy limits to the personal injury claimant, the insured was never damaged because no judgment was ever entered against the insured defendant. Thus, no bad faith cause of action ever accrued, even assuming for the sake of argument that the decisions made by the primary carrier to reject settlement proposals within policy limits were unwise or in bad faith.

Under California law, a plaintiff's failure to state facts sufficient to constitute a cause of action is equivalent to a lack of subject matter jurisdiction. *Unruh v. Truck Insurance Exchange*, 7 Cal.3d 616, 622; 498 P.2d 1063, 1068 (1972). The lack of subject matter jurisdiction may be raised on appeal for the first time. 7 Cal.3d at 662; 498 P.2d at 1068.

The record of the District Court shows that, in its answer to the first amended complaint, defendant Royal Surplus Lines Insurance Company pleaded that Northfield Insurance Company had failed to allege facts sufficient to constitute any cause of action for bad faith. Thus, the sufficiency of the plaintiff's pleading was raised at the trial court level. Even if it had not been raised, the defendant was entitled to raise the lack of subject matter jurisdiction in the United States Court of Appeals for the Ninth Circuit.

Since the lack of subject matter jurisdiction negates the constitutional requirement of a "case" or "controversy," Royal Surplus Lines Insurance Company is entitled to raise the issue of subject matter jurisdiction in this court. The lack of such jurisdiction is fatal to Northfield's case.

II. The Lack of Subject Matter Jurisdiction Can Never Be Waived, and a Federal Appellate Court Must Reverse a Judgment Based on a Cause of Action That Does Not Exist, and Must Order Dismissal of the Case.

Article III, Section 2 of the United States Constitution limits federal courts to the decision of "cases" or "controversies." *Arizonans for Official English v. Arizona*, 520 U.S. 43, 64 (1997). A plaintiff's standing to sue "is an aspect of the case or controversy requirement." 520 U.S. at 64. In order to qualify as a party with standing, the plaintiff must show the " 'invasion of a legally protected interest.' " 520 U.S. at 64.

The requirement that the plaintiff has made out a case or controversy between the plaintiff and the defendant, under Article III, is "the threshold question

in every federal case, determining the power of the court to entertain the suit." *Warth v. Seldin*, 422 U.S. 490, 498 (1975). In determining whether the plaintiff has standing, "[b]oth the trial and reviewing court must accept as true all material allegations of the complaint, and must construe the complaint in favor of the complaining party." 422 U.S. at 501. However, if the plaintiff does not establish standing, "the complaint must be dismissed." 422 U.S. at 502.

A plaintiff must show "an injury to himself that is likely to be redressed by a favorable decision" in order to establish standing. *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 38 (1976). Without such a showing, "exercise of its power by a federal court would be gratuitous and thus inconsistent with the Art[icle] III limitation." 426 U.S. at 38.

The decisions of this Court "have established that the irreducible constitutional minimum of standing contains three elements." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992). *First*, a plaintiff must have suffered an " 'injury in fact,' an invasion of a legally protected interest." 504 U.S. at 560. *Second*, "there must be a causal connection between the injury and the conduct complained of - the injury has to be 'fairly ... trace[able] to the challenged action of the defendant.' " 504 U.S. at 560. *Third*, it must be " 'likely,' " as distinct from " 'speculative,' " that the plaintiff's alleged injury will be redressed by a favorable decision. 504 U.S. at 561.

It is apparent that Northfield Insurance Company cannot meet the three requirements summarized by this Court in the *Lujan* decision. Northfield never suffered an injury. It merely contributed to a settlement in

accordance with its excess liability insurance contract, to avoid any claim of bad faith or breach of contract against Northfield. The insured was never damaged, and thus the insured never had a cause of action against its primary carrier, Royal Surplus Lines Insurance Company, to which Northfield could subrogate. Moreover, there was no causal connection between Northfield's settlement contribution and any act or omission on the part of Royal. The alleged failure of Royal to settle within its policy limits was not wrongful or actionable, unless and until the time of entry of judgment against Royal's insured, which never happened. Since the governing California law does not recognize any bad faith cause of action without entry of judgment, where an insurer is defending its insured in a lawsuit, there never has been any proper basis to conclude that the facts alleged by Northfield in its first amended complaint would likely result in redress.

Every federal appellate court has a special obligation to satisfy itself not only of its own jurisdiction, but also of the jurisdiction of the lower courts in cases under review, even where the parties have conceded jurisdiction. *Steel Company v. Citizens for a Better Environment*, 523 U.S. 83, 95 (1998). If the record discloses that a lower court was without jurisdiction, a federal appellate court has jurisdiction " 'not of the merits, but merely for the purpose of correcting the error of the lower court in entertaining the [law]suit.' " 523 U.S. at 95.

Rule 12(b) of the Federal Rules of Civil Procedure provides that "[e]very defense to a claim for relief in any pleading must be asserted in the responsive

pleading if one is required." In this case, Royal pleaded the insufficiency of the purported cause of action for bad faith failure to settle as an affirmative defense.

Some affirmative defenses, including lack of subject matter jurisdiction, may be asserted by a motion pursuant to rule 12(b) of the Federal Rules of Civil Procedure. Rule 12(h) provides that certain defenses may be waived if not raised, but the defenses that may be waived do not include the absence of subject matter jurisdiction. In fact, rule 12(h)(3) of the Federal Rules of Civil Procedure provides that "[i]f the court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action." The same rule is established by statute, 28 U.S.C. § 1447(c).

Because the issue of subject matter jurisdiction involves a court's power to hear a case, it can never be forfeited or waived. *Arbaugh v. Y & H Corporation*, 546 U.S. 500, 514 (2006). Furthermore, all courts, including the Supreme Court of the United States, "have an independent obligation to determine whether subject-matter jurisdiction exists, even in the absence of a challenge from any party." 546 U.S. at 514. "[W]hen a federal court concludes that it lacks subject-matter jurisdiction, the court must dismiss the complaint in its entirety." 546 U.S. at 514.

In this case, a judgment worth over $10,000,000.00 with interest was based on a cause of action that never came into existence. Although the defendant pleaded that the plaintiff's first amended complaint failed to state facts sufficient to constitute a cause of action, the District Court implicitly overruled this defense when it

granted partial summary judgment. The District Court confused the issue of whether certain conduct in rejecting settlement proposals constituted bad faith with the issue of accrual of a bad faith cause of action. Even if the rejection of a settlement opportunity can be said to have been in bad faith, no cause of action materializes unless and until there has been a judgment against the insured.

In addition to raising the lack of subject matter jurisdiction in its answer, defendant Royal Surplus Lines Insurance Company filed a motion for summary disposition of the appeal in the United States Court of Appeals for the Ninth Circuit, prior to briefing on the merits. The court denied this motion without prejudice.

Royal then raised the absence of subject matter jurisdiction in its appellant's opening brief, but the Ninth Circuit virtually ignored the issue. It affirmed the judgment that lacked any legal basis, citing *In re E. R. Feyert, Inc.*, 887 F.2d 955, 957 (9th Cir. 1989). This case dealt with the duty of a litigant, under certain circumstances, to secure a ruling at the trial court level in order to preserve that issue for appeal. The issue in question in the case, however, involved a bankruptcy preference, not the fundamental constitutional issue of lack of subject matter jurisdiction.

In this diversity case, the plaintiff sued on a cause of action that never existed, secured a partial summary judgment establishing liability on that cause of action, and was awarded a massive monetary judgment. The nonexistence of the cause of action means that there never was subject matter jurisdiction at the trial court level.

The United States Court of Appeals for the Ninth Circuit should have found that there was no subject matter jurisdiction, due to the absence of a recognized cause of action under California law. There was no bad faith cause of action, because the underlying lawsuit was settled prior to judgment, avoiding any damage to the insured defendant, and avoiding the accrual of any cause of action arising from the primary insurer's failure to accept settlement proposals within policy limits. Since the insured had no cause of action, the excess insurer had no cause of action to which to subrogate.

The remedy for lack of subject matter jurisdiction is to reverse any lower court judgment and order dismissal. Royal Surplus Lines Insurance Company is entitled to reversal of the judgment against it, with directions that the complaint against the company be dismissed.

III. There Are Compelling Reasons to Grant Certiorari, Including the Need to Provide Guidance to the Insurance Industry, and the Need to Ensure That Lower Courts Follow the Decisions of the Supreme Court of the United States With Respect to the Constitutional Issue of Subject Matter Jurisdiction.

Rule 10 of the rules of the Supreme Court of the United States provides as follows:

> Review on a writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only for compelling reasons. The following, although neither controlling nor fully measuring the Court's discretion, indicate the character of the reasons the Court considers:
>
> > (a) *a United States court of appeals* has entered a decision in conflict with the decision of another United States court of appeals on the same important matter; has decided an important federal question in a way that conflicts with a decision by a state court of last resort; or *has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's supervisory power*;

> (b) a state court of last resort has decided an important federal question in a way that conflicts with the decision of another state court of last resort or of a United States court of appeals;
>
> (c) a state court or *a United States court of appeals* has decided an important question of federal law that has not been, but should be, settled by this Court, or *has decided an important federal question in a way that conflicts with relevant decisions of this Court.*
>
> A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law.

(Emphasis added.)

It is respectfully suggested that this Court should exercise its discretion in favor of granting certiorari in this case.

As demonstrated above, and as shown in the briefs on the merits filed in United States Court of Appeals for the Ninth Circuit, California law does not recognize a cause of action for a primary insurer's bad faith failure to settle within policy limits, unless and until a judgment has been entered against the insured. It is undisputed that no judgment was entered against the company insured by Royal Surplus Lines Insurance Company (the primary insurer) and by Northfield Insurance

Company (the excess insurer). Because of the absence of a judgment against the insurer's common insured, no cause of action for bad faith ever came into existence.

The Ninth Circuit failed to consider the legal effect of the nonexistence of the cause of action on which the District Court judgment was based. Rather, the Ninth Circuit simply cited an irrelevant case dealing with the general principle that preservation of an issue generally requires that a litigant seek a precise lower court ruling on the issue. This principle does not apply, however, to the absence of subject matter jurisdiction, a matter of constitutional magnitude.

It is respectfully submitted that affirmance of a judgment based on a cause of action that never accrued is an extreme departure from the accepted and usual course of judicial proceedings, so as to call for the exercise of the supervisory power of this court. This court has consistently recognized that, if there is no cause of action, there is no case or controversy within the meaning of Article III of the Constitution.

The Supreme Court has always held that the lack of subject matter jurisdiction requires dismissal of a case, even if the absence of such jurisdiction is raised at the appellate level. By refusing to order dismissal of this case, the Ninth Circuit has decided an important federal question in a manner in conflict with the relevant decisions of the Supreme Court, which are cited above.

It should be noted that the present case is of considerable importance to the insurance industry, in California and across the nation. There has been a

considerable amount of attention devoted to this case in the trade press, including three separate articles in *Insurance Coverage Litigation Reporter*, a publication of Andrews Publications, Inc., a Thomson West business. In addition, there has been a detailed article in Mealy's publication *Insurance Pleadings*.

In light of rule 32.1 of the *Federal Rules of Appellate Procedure*, the memorandum decision of the Ninth Circuit in this case can be cited everywhere. Settled law has become unsettled. Most liability insurers have, for many years, relied on the rule that they cannot be sued for bad faith failure to settle a case that they are defending, unless and until an excess judgment has been rendered against the insured.

Uncertainty as to the obligations of liability insurers can only destabilize insurance markets, as well as interfere with the settlement process in cases that have reached the stage of litigation. Insurers should be encouraged to reach settlements in cases against their insureds, and should not be punished for doing so. Excess insurers should pay settlements above and beyond primary limits. They should not be permitted to transfer their obligations to primary insurers.

CONCLUSION

For all of the foregoing reasons, the petitioner respectfully requests that the Supreme Court of the United States grant this petition and review the matter. The constitutional requirement of subject matter jurisdiction has been ignored by the lower courts. Dismissal of the plaintiff's case should be ordered, due to the absence of any cause of action supporting the judgment that was entered by the District Court.

Respectfully submitted,

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